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ASB meeting minutes, 1998, September 15-17

American Institute of Certified Public Accountants. Auditing Standards Board

ASB Meeting Minutes, September 15-17, 1998

File Ref. No. 1400
Auditing Standards Board
Approved Highlights
September 15-17, 1998

Auditing Standards Board

Meeting:	Auditing Standards Board
Date:	September 15-17, 1998
Location:	Rio Suite Hotel & Casino I-15 and Flamingo Post Office Box 14160 Las Vegas, NV 89114
Meeting Attendance:	Deborah D. Lambert, Chair James S. Gerson, Vice-Chair John L. Archambault John Barnum Andrew J. Capelli

Richard Dieter
Stephen D. Holton
J. Michael Inzina
Norwood J. Jackson, Jr.
Charles E. Landes
Stephen McEachern
Kurt Pany
Alan Rosenthal
Robert C. Steiner
George H. Tucker

Other Participants

W. Ronald Walton, Chair, Attestation Recodification I Task Force
Thomas Ray, Director, Audit and Attest Standards
Gretchen Fischbach, Technical Manager, Audit and Attest Standards
Kim Gibson, Technical Manager, Audit and Attest Standards
Jane M. Mancino, Technical Manager, Audit and Attest Standards
Judith M. Sherinsky, Technical Manager, Audit and Attest Standards

Observers

James Carey
Dave Frazier
Chris Galer
John Lucca
Jeffrey Thomson
Deborah Koebele

I. CHAIR AND VICE CHAIR'S REPORT

Deborah D. Lambert, Chair, and James S. Gerson, Vice Chair, reported on the Audit Issues Task Force (AITF) meetings of August

26-27, 1998. A copy of the meeting highlights is attached.

II. DIRECTOR'S REPORT

Thomas Ray, AICPA Director—Audit and Attest Standards, reported on the following matters to the ASB.

A. Norwood (Woody) Jackson, ASB member, has been recognized by the AICPA as the 1998 Outstanding CPA in Government.
B. Meeting with the Securities and Exchange Commissions (SEC) Chief Accountant

On August 26, 1998, representatives of the ASB met with SEC representatives at the SECs offices in Washington, D.C. Participants at the meeting included Lynn Turner, Chief Accountant, Jane Adams, Deputy Chief Accountant, and professional practice fellows representing the SEC Office of the Chief Accountant; Greg Corso, Counsel to the SEC Chairman; D. Lambert, J. Gerson, A. Capelli, D. Dieter and Randy Fletchall (a partner with Ernst & Young LLP, in the absence of ASB member George Tucker) representing the ASB; Jerry Sullivan, representing the Public Oversight Board; and T. Ray and Arleen Thomas, representing the AICPA staff.

We were invited to the meeting to discuss "earnings management" not in accordance with generally accepted accounting principles. The specific subject matter discussed at the meeting was related to three general areas: revenue recognition, restructuring charges, and corporate governance.

Based on their analysis of recent articles in the press, enforcement actions, and discussions with others, Mr. Turner is concerned that improper revenue recognition continues to be a problem for the profession. He asked the ASB to take some action in this area. We held a general discussion about the issue to gain a better understanding of its pervasiveness. We also apprised the SEC staff of actions the AICPA has taken in the recent past, and agreed to study the matter to determine whether additional appropriate actions need to be taken. The AITF will report on the status of this consideration during our liaison meeting scheduled with the SEC for October 7, 1998.

The SEC staff expressed general disappointment with the amount of interaction between audit committees and independent auditors. In 1994, the Advisory Panel on Auditor Independence made a report to the Public Oversight Board of the AICPA SEC Practice Section (SECPS). That report, Strengthening the Professionalism of the Independent Auditor, made numerous recommendations to increase interaction between independent auditors and audit committees. Mr. Turner made reference to the apparent lack of widespread implementation of those recommendations. He asked the ASB to consider whether it can take actions to increase their adoption.

Also, in some recent instances where the SEC staff questioned the accounting used by a registrant, the SEC staff found that neither the auditor nor management consulted with the registrants audit committee prior to meeting with the SEC staff to discuss the accounting. Although for a variety of reasons, including timing, this may not be indicative of a violation of the auditing standards, the SEC staff suggests that this situation is not desirable.

The SEC staff expressed concern about the application of the accounting rules related to restructuring charges and the recognition of certain liabilities in connection with purchase business combinations. The accounting for these matters is specified by Emerging Issues Task Force (EITF) Issues No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring), and No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination. The application of these rules appears to be inconsistent among different entities, and in some instances within individual entities. We discussed that the discretion of management is among the criteria for recognizing these amounts. This probably is one reason for the variability. Mr. Turner also stated that there are numerous instances where entities are not making all the disclosures required by the EITF.

C. AICPA Staff Actions in Response to SEC Concerns

AICPA staff have undertaken several actions to begin to address the SECs concerns about improper revenue recognition.

1. Audit Practice Guidance

AICPA will publish practice guidance for auditors similar to the guidance published in October 1997, The Year 2000 IssueCurrent Accounting and Auditing Guidance. Such guidance would be made available on the AICPAs Web site and in print. It will include a general discussion of relevant accounting literature on revenue recognition; managements responsibility for adopting appropriate revenue recognition policies; warning signs of improper revenue recognition; and the application of generally accepted auditing standards to the audit of revenues (including Statement on Auditing Standards No. 82, Consideration of Fraud in a Financial Statement Audit). Staff is identifying members of the ASB, Accounting Standards Executive Committee, Technical Issues Committee, Professional Issues Subcommittee, Quality Control Inquiry Committee, and the SECPS for the steering task force. Julie Anne Dilley, AICPA technical manager, volunteered to draft the guidance and is in the process of developing an outline.

2. Audit Risk Alert

T. Ray agreed to work with the AICPA publications team to enhance the guidance on improper revenue recognition included in the initial draft of the

1998/1999 Audit Risk Alert. T. Ray also prepared some articles for the Alert to address some of the other concerns expressed by the SEC. The subjects include disclosure related to restructuring charges and the recognition of certain liabilities in connection with purchase business combinations; accounting for impairments of long-lived assets; and communications with audit committees.

D. International Joint Project on the Audit Model

T. Ray, G. Fischbach and Dick Dieter, ASB member, participated in the inaugural meeting of a joint project with the Canadian Institute of Chartered Accountants (CICA) and the Institute of Chartered Accountants of England and Wales (ICAEW). The overall objective is to reconsider the basic approach to audits of financial statements and identify whether standards setters should undertake to change the audit model. One aspect of the project is to study audit approaches currently being implemented by audit firms, consider whether they warrant near term action by standards setters, and make recommendations to national and international standards setting bodies. This project is a direct result of efforts by the ASB and AICPA staff to increase US participation in the development of the profession internationally.

The AICPA agreed to undertake substantial portion of the first stage of the project, which is targeted for completion in February 1999. In this first stage, we will interview the individuals who led the development of the new audit approaches being implemented by the large CPA firms.

E. IAPC Project Proposal on Derivatives

T. Ray and G. Fischbach met with representatives of the ICAEW and CICA, and the German member of the International Auditing Practices Committee (IAPC) to discuss a joint project proposal to the IAPC to develop auditing guidance for derivative financial instruments. At the June meeting of the IAPC, T. Ray volunteered US resources to develop the proposal, and the IAPC members from Canada, the UK and Germany expressed an interest in helping to develop the proposal. The proposal will be presented to the IAPC at its meeting in October 1998.

F. Year 2000 Task Force

On July 30, 1998, the Year 2000 Task Force met with John Koskinen, Assistant to the President of the United States and Chair of the Presidents Council of the Year 2000 Conversion, to exchange information about efforts to mobilize responsible parties to address the Year 2000 Issue. This was the second of a series of periodic meetings to keep each other apprised of year 2000 efforts and developments.

Wynne Baker, chair of the AICPA Banking and Savings Institutions Committee, and Brad Davidson, AICPA technical manager and staff liaison to that Committee, attended the meeting to share some of the Committees concerns about the Year 2000 Issue, and seek the assistance of the task force in resolving them. Financial institution examiners appear to have expectations about the role of independent auditors in addressing the adverse effects of the year 2000 that exceed the professions understanding of its responsibility. Some of these expectations may have been created by guidance issued by the FFIEC, a Federal organization with the authority to issue guidance to financial institution examiners. W. Baker and B. Davidson recommended that we try to meet with the FFIECs year 2000 task force to discuss these concerns and recommend a means to mitigate them. T. Ray and G. Fischbach agreed that it would be appropriate to identify a member of the ASB to participate in such a meeting.

G. Meeting with the Federal Financial Institutions Examination Council (FFIEC) Year 2000 Task Force

On September 1, 1998, J. Gerson, W. Baker, Peter Sabella, AICPA Banking and Savings Institutions Committee member, T. Ray, G. Fischbach, and B. Davidson, met with the FFIECs year 2000 task force. The purpose of the meeting was to discuss the role of independent auditors in addressing the Year 2000 Issue, and our concerns about FFIEC guidance to financial institution examiners. The FFIEC year 2000 task force members agreed to consider whether their guidance should be clarified. AICPA representatives agreed to prepare a short series of questions and answers, for publication by the FFIEC, to explain the independent auditors responsibility for the Year 2000 Issue in an audit of financial statements conducted in accordance with generally accepted auditing standards. The FFIEC task force agreed to consider the questions and answers for possible publication.

III. AGENDA ITEMS PRESENTED AT MEETING

Ownership, Existence and Valuation (File Ref. No. 2405):

The Ownership, Existence, and Valuation task force is considering the auditors responsibility for auditing financial statement assertions about financial instruments. Stephen Holton, chair of the task force, presented a revised draft of a proposed Statement on Auditing Standard that would provide a framework for auditing all financial instruments. The proposed SAS would supersede SAS No. 81, Auditing Investments, the scope of which only includes (1) debt and equity securities, as that term is defined in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities, and (2) investments accounted for under APB Opinion No. 18, The Equity Method of Accounting. The proposed SAS also would provide guidance on how the auditor satisfies the SAS No. 55 requirement to obtain a sufficient understanding of an entitys internal control to plan the audit in situations in which a separate organization, such as a custodian or broker-dealer, processes financial instrument transactions for an entity or maintains custody of its financial instruments.

The ASB—

- Agreed that the guidance developed by the task force should be issued in two documents:

    1. A SAS that contains general guidance about auditing financial instrument assertions
    2. An auditing practice release that supplements the SAS by providing more detailed guidance, explains how to apply the SAS to various types of financial instruments, and presents case studies.
- Reaffirmed its previous conclusion that paragraph 3 of SAS No. 70, should be revised to clarify its applicability, and to incorporate the language and concepts in SAS No. 55, Consideration of Internal Control in a Financial Statement Audit. Paragraph 3 currently states that SAS No. 70 is applicable to the audit of the financial statements of an entity that obtains either or both of the following services from another organization:
    0. Executing transactions and maintaining the related accountability
    1. Recording transactions and processing related data

        Paragraph 3 would be revised to state that the SAS is applicable when an entity obtains services from another organization that are part of its "information system."

- Agreed that the SAS should state that the extent of the understanding of internal control the auditor needs to satisfy the SAS No. 55 requirement to plan the audit does not change whether the information system related to financial instrument transactions is entirely within the entity or at a service organization.

SOP 98-8 For Year 2000 Agreed-Upon Procedures Engagements:

D. Lambert and J. Gerson presented SOP 98-8 to the ASB for discussion. They explained that earlier this year, the CFTC issued Advisory No. 1798 indicating that a year 2000 problem, as defined therein, constitutes a material inadequacy within the meaning of CFTC Regulation 1.16, thus triggering certain notification requirements applicable to CFTC registrants and their accountants. In releases issued in July 1998, the SEC solicited comments on the appropriate type of review that an accountant could perform on broker-dealers and transfer agents assertions regarding their process for preparing for the year 2000.

Given the nature of the Year 2000 Issue, an agreed-upon procedures attestation engagement is the only type of engagement that a practitioner can perform regarding assertions on year 2000 readiness or lack of material inadequacies relating to the Year 2000 Issue. Accordingly, the AICPA formed the Securities Industry Year 2000 Agreed-Upon Procedures Task Force with representatives from the ASB, Stockbrokerage and Investment Banking Committee and SEC Regulations Committee. This Task Force developed SOP 98-8 which provides guidance on the application of selected aspects of Statement on Standards for Attestation Engagements No. 4 to agreed-upon procedures attestation engagements that would satisfy the SEC and CFTCs reporting objectives.

After discussion, the ASB recommended the following changes to the draft of SOP 98-8:

- Paragraph 34—delete from the first sentence the phrase "that have such a significant adverse effect on the entity" and edit the rest of the sentence accordingly.
- Procedure 7a-c of appendix A (and the corresponding procedure in all other appendixes)—edit the last sentence to read as follows (new language is underlined) "An exception would be reported if, as a result of this procedure, management of a significant business unit identifies..."
- Delete item number 6 of appendix A (and the corresponding item in the other appendixes) and move the concept of management oversight contained therein to a separate category under item number 2.
- Edit the first sentence under item 7a-c of appendix A (and the corresponding item in the other appendixes) to read as follows (new text is underlined) "We inquired of management of five (5) randomly

selected [or 100% if less than 5] significant business units and obtained written representations therefrom, as to whether..."
- Edit items 7i-j (and the corresponding item in the other appendixes) to read as follows (new language is underlined "We read reportsincluding those found to be necessary as a result of testing or delays in schedule have been made."
- Under item 2m, replace the word "human" with the word "staff."

The ASB approved SOP 98-8 for issuance, subject to the changes recommended above.

Reporting On Consistency (File Ref. No. 4263):

Richard Dieter, chair of the Reporting on Consistency Task Force (task force) led a discussion of two issues papers prepared by the task force. The following are the issues presented in the issues papers:

- The possible elimination of the consistency reference in the auditor's report, and
- Revising AU section 420, Consistency of Application of Generally Accepted Accounting Principles, paragraphs .07.10 to clarify that a different reporting entity resulting from a transaction or event does not require adding an explanatory paragraph about consistency and removing the requirement that the auditor's report be modified for both a generally accepted accounting principles (GAAP) departure and a consistency reference when a pooling of interests is not accounted for correctly.

The issues paper discussing the elimination of the consistency reference discuss included pros and cons for eliminating mandatory accounting changes only and both mandatory and voluntary accounting changes.

The task force's preference would be to remove the consistency reference for both mandatory and voluntary accounting changes; however, R. Dieter informed the ASB that he will speak to the SEC representatives regarding removing the consistency reference for both mandatory and voluntary changes in accounting principles at the next AITF-SEC liaison meeting to be held in October 1998 before attempting to do so.

After discussion of the pros and cons of eliminating the two types of accounting changes, the task force agreed to proceed with drafting a standard that eliminates the consistency reference for a mandatory change in accounting principles. If the SEC agrees with the elimination of the consistency reference in its entirety, the task force will draft the proposed standard accordingly.

After discussion of the second issues paper referred to above, the task force also agreed to include in the proposed standard clarification that a different reporting entity resulting from a transaction or event does not require adding an explanatory paragraph about consistency and removing the requirement that the auditor's report be modified for both a GAAP departure and a consistency reference when a pooling of interests is not accounted for correctly

The task force plans to present a draft of a proposed standard regarding reporting on consistency to the ASB at its November 1998 meeting.

Attestation Recodification I (File Ref. No. 2155):

W. Ronald Walton, chair of the Attestation Recodification Task Force, led the ASBs discussion of the project. The exposure draft of the proposed Statement on Standards for Attestation Engagements (SSAE), Amendments to SSAE Nos. 1, 2 and 3, was issued on June 1, 1998; the comment period ended on July 31, 1998. The ASB received a total of 17 comment letters on the proposal.

R. Walton noted that three major changes were made as a result of issues raised in the comment letters:

1. Paragraph 50 of SSAE No. 1 was revised to indicate a preference for reporting on the subject matter, rather than on managements assertion.
2. A paragraph dealing with Type 2 subsequent events was added to SSAE No. 2.
3. SSAE No. 3, paragraph 66, on material uncertainties was revised.

The ASB—

- Concluded that the proposed SSAE should not state a preference for reporting on the subject matter or managements assertion.
- Discussed reporting on a compliance attestation engagement when a material uncertainty exists. The ASB agreed that there need not be consistency between the auditing and attestation standards when a material uncertainty exists and agreed to delete any reference to scope limitations in the discussion of that issue. The ASB also discussed providing example reports for these circumstances but ultimately decided not to provide example reports.
- Voted to ballot for issuance as a final SSAE (see summary of Board Preference Vote).

Summary of Board Preference Vote
Attestation Recodification (File Ref. No. 2155)

	For	Against	Abstain	Absent
Should the draft be balloted for issuance as a final SSAE?	15	-	-	-

Electronic Dissemination Of Financial Information (File Ref. No. 2505):

John Archarmbault, chair of the Electronic Dissemination of Financial Information Task Force (task force) and Kim Gibson, staff liaison to the task force, discussed the results of a questionnaire published by the task force and the direction the task force plans to take.

The questionnaire and a summary of the responses were discussed with the ASB. The task force asked members to complete the questionnaire in order to gather views with respect to various issues surrounding the presentation of audited financial information and the related auditor's report on a company's Web site. The summary of responses included the percentage of yes and no answers, along with the written responses to the questions.

After discussion of the questionnaire, the task force agreed to draft nonauthorative guidance in the form of an article on the subject and incorporate some of the information obtained from the questionnaire into the article. The ASB also asked the task force to return at the December ASB meeting with an issues paper identifying various sections of the professional literature which may need to be revised to reflect electronically disseminated financial information.

Attachment to Highlights of Auditing Standards Board Meeting
September 15-17, 1998
Las Vegas, NV

HIGHLIGHTS OF AITF MEETINGS OF AUGUST 26-27, 1998

Meeting of August 26, 1998

The Audit Issues Task Force (AITF) met on August 26, 1998 in Washington, D.C. The following are highlights of that meeting.

Fraud Task Force Charge

Andrew J. Capelli, Chair, and Jane Mancino, staff liaison, of the Fraud Standard Steering Task Force, led a discussion about the task forces revised charge. The task force will coordinate research on the effectiveness of SAS No. 82, Consideration of Fraud in a Financial Statement Audit, and on the continuous improvement of guidance on detecting financial statement fraud; monitor and support the International Auditing Practice Committees development of a fraud standard; and serve as a catalyst for other improvements in the prevention and detection of fraud. Ray Whittington, Director of the School of Accountancy at DePaul University and a member of the task force, is drafting a Request for Proposals (RFP) for academic research related to the implementation of SAS No. 82. The task force will discuss the draft RFP at its September 9 meeting and bring it to the AITF for approval at the AITFs next meeting on October 7. The task force also will discuss with the SECPS Executive Committee appropriate procedures to give the research team access to working papers without jeopardizing confidentiality. The task force plans to distribute the RFP in mid-October with a January 31, 1999 response deadline. The task force anticipates approval of a contract by mid-March. Research on the impact of implementing SAS No. 82 in 1997 and 1998 audits will occur over the summer and a draft of findings will be available early in 2000. Several AITF members noted that an exclusive focus on SECPS audits may fail to capture the impact of SAS No. 82 implementation in audits of state and local governments, not-for-profit entities, and possibly other industry segments. The task force will consider how to address this issue.

Preparation for GASB Liaison Meeting

Timothy J. Green, Chair, and Mary Foelster, staff liaison, Government Accounting and Auditing Committee (GAAC), updated the AITF on the status of various issues relating to the governmental financial reporting model that is being proposed by the Governmental Accounting Standards Board (GASB). Discussion focused on the guidance on audit materiality in the AICPA Audit and Accounting Guide, Audits of State and Local Governmental Units. AITF members expressed concern about the inconsistency in current practice of setting materiality for planning purposes at the fund type level while opining at the entity level. They also were concerned about existing AICPA guidance to qualify the auditors report on the general-purpose financial statements for the exclusion of immaterial funds. The AITF recommended that GAAC consider developing new guidance on materiality prior to issuance of the GASB standards on the new reporting model.

GASB and GAO Exposure Drafts

J. Michael Inzina, ASB member, led a discussion about a proposed GASB Technical Bulletin and two proposed GAO Government Auditing Standards. Other participants included Norwood J. Jackson, Jr. (on GASB proposal only), T. Green, and M. Foelster. The GASB exposure draft, Disclosures about Year 2000 Resources Committed, requires various financial statement disclosures about year 2000 issues, including stages of work needed to complete year 2000 compliance of critical systems and whether replaced or updated systems or equipment are year 2000-compliant. Participants noted that auditors would have to disclaim on such information because it is unverifiable. The SEC further has stated that it is not and will not be possible for management to represent that an entity has achieved year 2000 compliance.

The AITF also discussed two GAO exposure drafts, Auditor Communications and Additional Documentation Requirements When Assessing Control Risk at Maximum for Computer-Related Controls. Some participants expressed concern about the proposed requirement in Auditor Communications that an auditor who has issued separate reports on compliance and internal control must disclose in the report on the financial statements (1) a finding that reportable instances of noncompliance or reportable conditions in internal control were found, and (2) whether or not the tests performed provided sufficient evidence to support an opinion on compliance or internal control. Inclusion of information from restricted use reports on compliance and internal control in the general use report on the financial statements approaches a summary form of reporting that may render the report on the financial statements a restricted use report.

Additional Documentation Requirements When Assessing Control Risk at Maximum for Computer-Related Controls proposes documentation requirements beyond those of generally accepted auditing standards in assessing the control risk of assertions that are "significantly dependent" upon computer applications. In such circumstances, the auditor must document the basis for assessing control risk at the maximum level by addressing the ineffectiveness of the design or operation of controls, or the reasons why it would be inefficient to test the controls. It further requires documentation of the basis for concluding that planned audit procedures would achieve audit objectives and would reduce audit risk to an acceptable level. Participants noted that the proposed standard has a presumption that auditors should perform tests of controls, in contrast to the SAS No. 80 amendment of SAS No. 31, Evidential Matter, which leaves to auditor judgment the determination of when tests of controls may need to be performed in electronic environments.

The AITF asked M. Foelster to draft comment letters on the exposure drafts. The AITF also encouraged the establishment of more formal communications with GAO standards-setters.

Joint Task Force on Quality Control Standards Update

Barry Barber, Chair; Charles E. Landes, member; and Anthony J. Pugliese, Technical Manager, SEC Practice Section, of the Joint Task Force on Quality Control Standards (task force), presented the task forces preliminary decisions about the form and content of guidance to incorporate an experience requirement into professional standards pursuant to the issuance of the final version of the Uniform Accountancy Act in January 1998. The task force recommends drafting a new Quality Control standard to address the experience requirement, and further recommends defining experience in terms of competencies rather than length of service. A draft outline of the proposed standard positions the experience requirement as an additional part of the Personnel Management element of quality control; requires that firms establish policies and procedures to ensure that individuals who assume responsibility for signing attest reports meet certain minimum competencies; and includes examples of such competencies.

The AITF concurred with the task forces major recommendations. Some AITF members suggested that the task force drop certain of the more subjective competencies. AITF members also felt that the task force should develop wraparound implementation guidance that would be available concurrent with issuance of a final standard. This practice guidance might be similar to the AICPAs Guide for Establishing and Maintaining a System of Quality Control for a CPA Firms Accounting and Auditing Practice that illustrates how firms of various sizes can design and maintain quality control systems. The task force plans to present an initial draft of a standard to the Auditing Standards Board in November and expects that the ASB will vote out a standard for exposure at its December meeting. The AITF also asked the task force to present an outline of related implementation guidance to the ASB, and suggested that the practice guidance could be written while the proposed standard is being exposed for comment.

Other Topics

An agenda item concerning audit issues related to the recently enacted Taxpayer Confidentiality Act was deferred to the AITFs meeting on October 7, 1998.

Meeting of August 27, 1998

The Audit Issues Task Force (AITF) met with members and staff of the Financial Accounting Standards Board (FASB) on August 27, 1998 in Norwalk, CT. The following are highlights of that meeting:

Entities with Diminished Financial Flexibility

Deborah D. Lambert, Chair, Auditing Standards Board (ASB), led a discussion about auditors difficulties in applying SAS No. 59, The Auditors Consideration of an Entitys Ability to Continue as a Going Concern, in the absence of more substantive accounting guidance. David B. Kaplan, Chair, Accounting Standards Executive Committee (AcSEC), also participated. The discussion focused on two major issues. One is the lack of clear-cut guidance on when an entity should be using a liquidation basis of accounting rather than generally accepted accounting principles for which going concern is a presumption. The other issue is that there is no accounting guidance that specifically addresses "early warning" indicators of financial distress. FASB board member James J. Leisenring suggested that a working group of two FASB, two ASB, and two AcSEC members be established to further explore and develop recommendations on these issues.

Restructuring Reserves and Revenue Recognition Issues

Recent concerns expressed by the Securities and Exchange Commission (SEC) about restructuring reserves and revenue recognition issues were discussed. Participants noted that accounting guidance may be needed on disclosures about reversals of restructuring charges. James S. Gerson, Vice Chair of the ASB, reported that the SEC has recommended that the ASB consider developing additional auditing guidance, perhaps at the standards level, on evidence for revenue recognition. Participants also discussed the SECs recent focus on strengthening auditor communications with audit committees.

Derivatives and Hedging Transition Issues

Robert C. Wilkins, Senior Project Manager of the FASB, led a discussion about derivatives and hedging transition issues pursuant to the issuance of

Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities. He noted that potentially difficult issues relating to the implementation of the standard include managements documentation of designated hedges, identification of embedded derivatives, and estimation of fair value. He noted that the FASB has developed guidance on implementing the standard including a 60-page report on its Web site, familiarity with which is a prerequisite for training seminars that the FASB also is sponsoring.

Business Reporting Research Project Update

E. Raymond Simpson, Senior Project Manager of the FASB, discussed the FASBs two-year Business Reporting Research Project to consider types of information, in addition to financial statements, that companies are providing to users and the means by which such information is communicated. A steering committee whose members include preparers, users and auditors met on August 10 to form and assign tasks to seven working groups whose research efforts will include present practices on voluntary disclosure of information on operating data, risks and opportunities, and intangible assets not recognized in the financial statements; coordination of GAAP and SEC disclosure requirements to eliminate redundancies; and electronic dissemination of information. The steering committee will consider findings of the working groups, and develop and publish its recommendations.

Meeting of August 27, 1998

The Audit Issues Task Force (AITF) met with members and staff of the Governmental Accounting Standards Board (GASB) on August 27, 1998 in Norwalk, CT. The following are highlights of that meeting:

Reporting Model Issues

Kenneth R. Schermann, Senior Project Manager of the GASB, presented an update on the governmental reporting model. Financial statements for governmental and proprietary funds will focus on major funds rather than fund types. Presentation of the General Fund will be required. Presentation of major funds will be based on percentage tests of materiality, although subjective assessment also will permit the discrete presentation of funds that do not meet the percentage tests. Funds not captured by the percentage tests or subjective assessment will be reported in an "All Other" category. The governmental and proprietary funds statement totals will be consolidating totals (with interfund eliminations) rather than a memorandum total. A reconciliation of funds statements with the Net Assets and Changes in Net Assets of the entity-wide statements also will be provided.

Managements Discussion and Analysis (MD&A) will be presented as Required Supplementary Information (RSI). Some governmental entities may wish to have an attestation engagement performed on the MD&A. AITF participants recommended that the GASB look to the SECs criteria for MD&A to ensure that the GASB criteria are attestable. GASB representatives indicated that when revised criteria are available in October, they will ask the ASB to consider whether the criteria are reasonable criteria. The AITF suggested that the ASBs Attestable Criteria Task Force can help in evaluating whether the criteria are reasonable criteria to support practitioners performing an examination-level attestation engagement on MD&A.

Infrastructure

James R. Fountain, Assistant Director of Research of the GASB, presented an update on issues related to reporting of infrastructure assets in the entity-wide financial statements. The GASB has begun exploring options for infrastructure reporting other than historical cost with depreciation expense recorded in the statement of activities, which was the approach taken in the reporting model exposure draft. Several of the options being explored are termed "maintenance/preservation" approaches to infrastructure reporting and would require a periodic condition assessment for infrastructure assets that would be disclosed in RSI. Another option being considered is a historical cost/depreciation approach that also includes condition assessment. Given the complexities of the issues involved, the GASB has concluded that the historical cost/depreciation model will be incorporated into the entity-wide financial statements. Research on other options will continue and may result in the future issuance of a statement on infrastructure assets if the GASB determines that another infrastructure reporting model is more appropriate.

Proposed GASB Technical Bulletin on Year 2000 Issue

Terry K. Patton, Project Manager of the GASB, summarized the requirements of the proposed GASB Technical Bulletin, Disclosures about Year 2000 Resources Committed. AITF members noted that, while disclosure of information about managements plans and activities with regard to the Year 2000 Issue is useful, the financial statements are not the appropriate place for such disclosure. Some of the Technical Bulletins proposed disclosures regarding Year 2000 compliance are neither assertable by management nor verifiable by auditors and would result in auditors disclaiming on such disclosures. The comment letter being drafted by Mary Foelster would include examples of such report language for disclosures presented either in the financial statements or in RSI.

Materiality Issues in Governmental Reporting

Materiality issues in governmental reporting were briefly discussed, including AICPA plans to address the guidance on materiality in the AICPA Audit and Accounting Guide, Audits of State and Local Governmental Units. Participants agreed that recent meetings of representatives from the GASB, the AICPAs Government Accounting and Auditing Committee (GAAC), and the AITF were helpful in clarifying materiality issues. The AITF recommended that GAAC establish a working group with ASB and possibly GASB representatives to make recommendations on how the guidance should be revised.